North Devon's Leading Independent Wealth Managers

Dear Client *November 2023*

I hope you and yours are keeping well. The last time I wrote such an important letter was at the height of the Pandemic. We were all faced with grave uncertainty and the markets, economic and investment conditions were reacting wildly.

Market conditions now are not that bad but with incessant negativity the combined events are enough to escalate uncertainty demanding this specific letter, to guide and reassure you. None of us is immune from the effects of what has been happening.

Investors can over-react significantly despite the 'best' emotional stance being to stay calm and even to buy those cheap assets of yesterday which are likely to be even cheaper today. We also hold so many 'special opportunities' and indeed, it is not all negative news at all though we'd be economical with the truth if we suggested such special gains were commonplace and that we or most others elsewhere were ahead of the markets' general highs at the end of 2021.

The world has re-entered an unhappy place geopolitically and economically. Unbelievable atrocities from Russia's war against Ukraine and horrendous events in the Middle East frighten us all. These are added to the almost inevitable rush of inflation after the purse strings were relaxed after lockdowns and then rocketing interest rates and the pain this causes for borrowers, as well as anyone with cash being ravaged in real terms as prices rise way above meagre interest our deposits give us.

Humans hate uncertainty and react erratically and irrationally to it. That is understandable but we must recognise this ourselves, to help us make wise decisions even when it is uncomfortable. 'Economics' is the science of human beings interacting with cash and resources and their supply and demand. Investments are similar – prices of assets, from shares to commercial property, currencies, precious metals, collectables and homes in the short-term reflect people's present enthusiasm or revulsion for asset classes, excessively based on emotion. This is not based upon the underlying reality of the functional value of the asset involved. We have said before that bags of 100 £1 coins are for sale presently on the markets for far less than £100 and people are foolishly selling them rather than waiting for reality to return.

This letter is a warning – not an extreme one as things are nothing like as 'bad' as in March 2020 but still a siren to us all to not do the wrong thing but to consider doing the 'right' thing. It is our guidance – we have no crystal ball but I have been 'around the block' many times now and in the face of many global catastrophes, whilst involved in the world of finance for 45 years. That doesn't make me perfect by any means. A motto I have always pursued (and I hope in humility) is to learn continually from our 'mistakes' – why did that investment not go as 'hoped' and not to bask in sunshine arrogance of a brilliant result from something as if we convince ourselves we have the golden touch to everything we hold for our clients. That's also why we build-in robust measures protecting against excessive risks and exposures in strategies and a vast diversity of asset types, doing our best also to hold uncorrelated assets which can react differently (even oppositely) when facing global traumas.

So, what is the 'wrong thing'? Today, firstly make sure you do NOT sell your market-based assets now if you don't need the money (and that means don't be swayed by a slick salesman saying that their ideas would be far superior for you going forwards either – that simply incurs costs and fees to pay them and if that process takes a while, you could miss some of the best days the markets ever have, just by being caught between the stools). If you must switch, wait for stable conditions. If you do absolutely need the money for a planned or unexpected expense, then can the required sum be found from elsewhere? For example, cash in the bank, cash ISAs or Premium Bonds perhaps.

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Secondly, ensure you do not hold too much in cash or other relatively low-producing assets like National Savings, residential investment property, etc, because the value available in markets is so compelling in so many areas - once in a lifetime opportunities in many regards. So, apply that now and buy tremendous value and a great flow of income from a very diversified, 'balanced' strategy, based upon the sorts of component assets we have for our clients already. No, of course we cannot guarantee that 'today' has the lowest possible prices and that things will not worsen but today's starting point with 'value investments' and 'quoted funds' in so many ways has not been seen for a very long time.

Patience and time are crucial in the face of such events. Remember, we've endured and overcome similar conditions many times and have emerged stronger through the other side. Many upsets are simply short-term, disappearing as quickly as they start. I am not here to alarm anyone nor to be churlish, nor to suggest any major action by you, unless you can take advantage of this negativity to invest further capital for instance. If you take a high level of income from your investments, then a reduction or postponement of that for a while could benefit you as the surplus can be reinvested. Of course, if you need a sustainable level of income to pay bills, that's fine as it is unaffected by short-term capital moves. However, if clients can trim or cancel their fixed monthly incomes a little (where that cash is simply adding to bloated reserves) to help capital values, it is likely to be very wise.

We keep clients apprised of our views as regularly as we can – the most frequent being the typically fortnightly email – if you don't receive it, please tell me and we can add you to the distribution list.

Volatility is high – both on the downside but also, when it happens, going up too. I wonder how it will be when you receive this letter. We might well have passed the point of maximum pessimism. Despite all the negativity about these 'events' there is nothing priced-in for hope and positivity. No-one knows yet but if not, the trough is nearer than it was and indeed, the underlying markets may just be reflecting the fact that those who were forced to sell to raise cash may have done so. We hear from many other managers who would buy at depressed levels but they don't have funds from new investors and of course too many existing ones have instead panicked and asked them to sell stocks to send them cash. Then we hear from some who had cash reserves and have been nibbling-away at what they can and very cheaply. We all know market volatility is common and that is why we invest for the longer term whilst holding a good level of cash reserves for short-term needs.

In time, such events (which seem very significant now) are seen as small corrections when viewed as part of the bigger picture. Of course, we give our closest of attention to events developing, as we always do in such times. One place where share buying is strong is within funds and companies themselves – they use their considerable excess cash to buy-in and cancel their own shares which others dump. This is a great investment now – increasing outcomes for all remaining investors, as the whole returns are shared by a smaller number of loyal remaining shareholders.

We have passed the latest valuation point and reports reflect the gradual attrition or 'treading water' of no progress, as the few bright spots are blighted by the unforgiving markets which can inflict 'death by a thousand cuts' if that company or fund happens to announce something slightly negative. For the disciplined who can look-past current traumas, it is time to think about unused ISA and Pension contributions and needless to say, cash goes far further. We have had several deposits from those with spare cash availing themselves of such low values but it is not easy, we understand that.

Whilst not meant as a comparative to anything but perhaps contextualising things better, the FTSE250 (the index reflecting the capital progress of the UK shares from 101 to 350 in size), is a good reflection of the UK market more so than the FTSE100 (which is led by a few sectors and multinational entities). More people might be 'closer' to this with their holdings than any other comparative. Anyway, from the Pandemic trough in March 2020, by 3 September 2021 this index rebounded 78% to a new all-time high. Since then, it has been on a jittery slippage till it hit a more recent trough on 27 October 2023, having fallen 30%. It is now back at levels first seen in 2015, before the Brexit vote. Yes, with oils the FTSE100 has held-up much better recently but investors forget that on 31/12/99, almost 24 years ago when it too was buoyed by tech giants (then called 'technology, media and telephony') it peaked at 6,970 and is only now about 5% higher. The FTSE250, however, is even now some 1.75x higher than then (175% more). Don't forget your dividend income is on top of these figures and costs apply too.

I 'feel' we have seen the worst. These were similar words I used in March 2020 and I was right. I am not always

so discerning but I've ridden many awful times in my over four decades in this industry. Of course, we cannot afford to be blindly optimistic, as human emotional panic can continue driving irrational and extreme behaviour – such as those (including big fund managers who are simply humans) crystallising real and big losses to hide in cash. Remember you do not experience a loss unless you sell. You may well imagine that you are clever so you will sell and buy-back again cheaper but despite your perceived rational beliefs at the sales' point, you won't and at each subsequent fall you are chuffed in the justification and your prediction of weakness. Instead, it is likely to be far higher than your selling price when you feel conditions encourage re-entry. By that time, you will also have incurred selling and buying costs, to further reduce your returns.

The Chinese use different characters to write the word 'crisis;' One is for danger, the other for opportunity. In a crisis, be aware of the danger but as hard as it is, recognise the opportunity and no, I do not say that unfeelingly in view of the catastrophes unravelling across parts of our civilised world either. However, we shall overcome, as individuals and as a world.

The developed world will still have to face its colossal national debts and overspending on public services, with economies faltering as interest rate rises drive down inflation but that too seems to have peaked, with oil prices having dropped significantly again too on fears of slowing Chinese recovery.

Remember too, we are there for our clients. We can't change anything but we are trying our hardest to communicate as much as we can and with facts to reassure, if that is the right thing to do. Many in our industry just 'disappear' when things are hard – or indeed many investors are marooned as they have no contact from the theoretically 'cheap' transactional investment or pension products they acquired in the good times, so no one to help and talk to them during difficult times and potentially to save them a fortune by helping them not do the wrong thing by cashing-up in panic.

DIVIDEND, COMMERCIAL RENT AND INTEREST PAYMENTS – IMPORTANT

One result of lower market values is that you can buy a sustainable flow of regular income for a much cheaper price. There are now countless shares and indeed investment funds with ludicrously high income upon which investors can rely to pay the bills whilst their capital may be on a 'pause' for better times later. I shall give some examples of the sorts of value abounding now and which we have bought for clients. No, I am afraid we have not bought all of these types of assets at the cheapest levels either. However, even the FTSE100 (so the biggest 100 UK companies) has an income yield of nigh 4%pa now.

Companies are still making profits (the opposite is losses). They still pay dividends to their investors, a part of the profit. They must also pay their interest on loans and rents on properties. Remember the Pandemic when rents stopped and dividends cut or missed? Effectively almost all have now been made-up and dividends have hit all-time records. People who bought some of the cheapest assets in 2020 have done remarkably well in capital and income terms whilst their most crucial investment was 'patience'. If you think any such company or fund is going bust it is a bad buy. If you think it won't, then its value today could be cheap if in say two years it is four times higher and dividends on top. I suppose you could say that a small investment in an individual such entity is low risk versus a great prospective opportunity – and there are loads of similar examples again now.

These last few years, in aggregate our holdings have raised income payments significantly and we have added new assets with compelling flows of rents and dividends too. Therefore, portfolios generate very high levels of what we consider is reliable income as a byproduct of a diversified strategy which retains excellent prospective capital growth (and value preservation) qualities too. If clients don't 'need' the income then we recycle that into the best buying opportunities as they arise. We have a big range of components and whilst a hit to one is unwelcome, we do not have a big proportion of any investor's capital in one situation. Indeed, our biggest exposure to any asset (a fund) is just 2% of our total managed; there are just so many great opportunities and thus no excessive individual risk. Our biggest direct share is 1.4% of total assets (Rolls Royce Plc) and our second, a more speculative smaller company - McBride at 0.8% – much more than usual for both but that is because they have done so well for us since continuing buying through their troughs and purposefully, we have not yet trimmed our holdings.

SELLING PROTECTED INVESTMENTS

So, when is it 'right' to sell things which have held-up well against the negativity, to use that money to buy more of those which are most depressed, or do we conserve those 'safe' things till uncertainty goes? These may now be gold, silver or energy, supermarket companies or currencies and defensive/armaments stocks for example. We have trimmed or sold some and the reason is as much to raise cash to buy the far more depressed-in-price assets where our money goes much further. We have had a couple of takeovers (always welcome) too creating cash and we sold our holding in BAE Systems in full too.

But how can any investor, any manager, work rationally in such conditions? Let me quote a couple of examples to show how ludicrous things are. I did this too in March 2020 and named four assets then and it is interesting to reflect back to see what happened, the opportunities unlocked in due course and helping to propel our phenomenal recovery period afterwards. I could say I wish we had filled our boots with them all beyond the exposures we did have but that would be sheer greed and the wonderful use of hindsight when we can all be very clever. However, I am going to refer to some others we have now.

So, an investment fund has to cut the dividend as it has spent more on maintaining and improving its mainly office properties. The market hates that, worries about overall valuations of commercial property (despite its 82.5% occupancy rates and the strong rent roll) and then flaps about the borrowing the Trust has and the increased costs from rates. The shares drop and the Fund's capitalisation (number of shares x share price) falls to £137million, so below thresholds for some institutions to hold it, so they consider dumping it regardless of price. The cut dividend suggests an annualised income going forwards of a 'mere' 18%pa. So, this thing isn't under pressure to fire-sell assets (it is gradually selling properties, previously enabling debt to be reduced and that will continue). Since, it has announced the completion of a project and new rent of £558,277pa till 2037.

It seems to be mainly small shareholders selling-up and no-one buying. Pre-pandemic, on 14 February 2020 the shares were £1.21. At the time of writing, they are 28p – a drop of 77%. Investors often do 'silly' things sadly. So, some of the investors may have paid £1.21 are now selling because they have lost so much. Yes, that might seem wise if the price drops even more to say 20p or less – which can happen, as it is simply short-term supply and demand. However, at some point, the shares will rebalance to where they should be – or a corporate predator will say 'enough', buy the lot and make a tidy profit from a £0.75billion interesting portfolio of regional properties for a song and a quoted company to boot. Yes, things could still worsen (as I have said, the share price); they could suspend dividends to preserve cash, or lenders could frighten themselves and seek loan reductions or some inane loan covenants driving sales at the wrong time. However, there is a big comfort cushion. We have added to certain strategies and expect our total exposure, cash allowing, to be circa 1.5% of our overall assets in due time.

The second special situation which we have added is a secure loan fund, similar to the several of those we have already.

I shall not give all the details (which we analyse fully and there are a few other factors at play but not dissuading us) but it is larger than most (having invested over £1billion since it started over a decade ago) and it lends against assets like student accommodation, community living, residential property and care homes. It has a good spread with over 50 loans. Its largest exposure is only 8% of its assets. It has a small amount of borrowing too, generating a bigger return for investors as it costs less than the loan rates it charges. Yes, of course as already, it will have some loans that become sticky and some which may fail altogether but that is the same with any such business or bank. However, there is a significant comfort cushion here too.

Some paid £1 to buy at launch. It suited low risk investors; after all, its loans are asset-backed, by mortgages on property. It has done all it promised and paid a good income flow but appetite for its shares has waned. Its loans are all relatively short-term. Some roll or the repayment cash is recycled as expected. Yes, interest rates elsewhere have risen but so too have the rates it charges. One of its best recent investments is buying-in and cancelling its own shares as they have fallen to a deep discount to the loans' value. So 'today' assuming the asset value of all the loans is accurate (not said in cynicism of course), if we buy a share in this Fund, we do so at a price where if the Fund closed-down the next day (not expected!), we'd see an uplift in the capital value of 60%.

Meantime, we should continue to receive the dividends – some of the interest it receives on its loans. That is worth 11%pa. So for the £1,000 for a client we may subscribe now, that is £110 of income paid to us from interest collected on a large basket of secured loans and with a fair wind, a final redemption figure of £1,600 in due course as well.

For performance aficionados, beware, as there are people selling-out of this Fund's shares despite how it looks to us. They are selling because it has gone down – is that sensible? Should they not be wise and buy more cheaply?

The problem is, too many investors sell something (including whole portfolios of similar assets) on 'bad performance' despite the fact they should really be reflecting dispassionately on exactly what they hold, why it may have been limp and what is under the bonnet; you can't change yesterday but you can change tomorrow. Many of these assets pay great income whilst you need patience for change to come; and the risks from here are very low in our view. Remember too, with these 'funds' if things don't change then being forced to close-down, selling-up their assets becomes a reality to distribute our full share of the pot.

Presently, investment values are some of the most compelling we have seen for a very long time, especially investment 'funds' quoted on the Stock Exchange. Our view here is not even talking about 'company A' whose corporate prospects might suggest its share price should be higher but listed 'fund' companies which invest in baskets of securities, typically investments you can see and value but where prices at which the funds' shares trade are at big discounts to the collective values of those assets.

Yes of course there are risks – there are risks with 'everything' including life! However, cash under the mattress can be eaten by rot or stolen by thief and bank deposits can be decimated by inflation which is way above the meagre interest received. At the end of the day, many of these out-of-favour quoted funds will close-down, selling all their assets and returning cash to their investors. The cheaper they become, the far lower the risk they are too, yet at the same time the greater the opportunity for a colossal return for today's holders. Most of them also pay handsome incomes (as received from all their component investments) in the meantime. So far in 2023, we have had 13 corporate events affecting quoted funds, either leading to wind-ups or reviews which could lead to that. When a fund at a discount winds-up (or is taken-over) it generates a bonus for our investors on top of what the markets may produce 'normally'. We hold plenty of these and yes, many have fallen over recent months – frustratingly – but that doesn't make it wise to sell them. Instead, it is time to "bottom fish" – not that we can predict the absolute nadir. However, if you can buy funds owning collections of 'secure loans' say, for just under half the book value and whilst waiting, you receive a dividend (part of the loans' interest) at perhaps 11%pa, does that make sense? To us, yes!

These conditions boost income projections from portfolios too. Our latest figures have been calculated and the average for a 'balanced strategy' (however defined) is noting a sustainable income flow of over 5% and in many parts of those strategies, over 6% and nudging 7%. This is the by-product of a very diversified portfolio of different assets, some of which also pay nil (eg currencies and precious metals) as they are for capital security, designed to counterweight higher-paying holdings.

The problem is that if an investor looks at his valuation and thinks its value is dribbling-away for yet another quarter, what does it say? It says nothing helpful whatsoever. It is simply a single historical point (perhaps an hysterical one), that is all. The next day the price is different so the one that's been reported is stale and no longer relevant. Whatever you do, in these market conditions please don't force us to sell your portfolio of assets which contain so many similar examples to those above.

WHEN TO BUY AND WHY?

Even in normal conditions it is never an easy call. It is even harder now, aside from the fact that such value is perhaps more transparent than it's been for a very long time, especially with quoted funds which simply invest in other investments. There are companies like Abrdn Group Plc which is still using its surplus cash to buy-in and cancel its own shares which were unloved before and are back down again, despite colossal surpluses in its business assets. But why haven't more cash rich companies been pouncing whilst the value is so good? Why aren't more companies with cash even buying-in and cancelling their own shares as many are? Sadly, they too are driven by emotional humans who in the main choose to want to worry about further future uncertainty rather than being value contrarians.

THE FUTURE

Anyway, here is the prospective outlook. When you and I look at the present financial situation, our eyes are distracted by the storms causing depressed prices. We are fearful – both at individual levels and together. We are also very alarmed for work, our businesses, our mortgages, conflict outcomes, our investments and their income and state finances and the economy. I say 'our' here to signify not just 'us' but our concerns for everyone else. What about house prices if many borrowers can't manage their excessively large mortgages taken-out with short-term fixed rates so much lower than available now? But we must keep perspective. There have been far worse situations. There are still 8billion people in the world, with growing consumption and economic output, concentrated upon Asia.

We must all remember the chart of stockmarket performance. Yes, this is an historical record, a simple line of the 'market' over the years, back to when the opportunity of investing and trading in companies began. Consider the Great Depression in the early 1930s, centred upon the States but not excluding us. Think about what WW1 and WW2 did to our nations and indeed others worldwide (and I am excluding other regional wars but their impact on many nations has been similar). There was also the Spanish flu which killed more than died in all of WW1. Remember the 1970s' three-day week, the 'great' strikes, the oil price shock which saw our inflation hit almost 30%, or when mortgage interest rates exceeded 15%. We are so much further advanced technologically than before. We have so much more and indeed cash savings are vast compared with personal savings 30 years ago let alone 100. We are and shall remain wealthy as will all the developed and developing world, the investing world. Deposits and 'money market funds' have exploded these last few years. The chart ignores all 'noise' from those bad times. We look at it without emotion, a simple line where we see when it was cheap and when it was dear. The reasons for either almost seem irrelevant. Do not forget, there were other awful events which created those other times too and to which the line of history, the chart and our emotions about them, are oblivious.

All of us will still want feeding, clothing and sheltering. We want communications, energy, heating, water, travel, finance and insurance. The majority has or can afford medicine, education and care and yes, it will also entertain itself, holiday, relax, collect things, garden, visit, eat out, watch and do sports, play and attend music events. From this 'normal' activity, business will survive and thrive and whilst some will fail, those enduring will be in great demand, even if people have to review their own finances and spending in terms of what they can afford.

So, we need to look at the chart and disconnect from today's storms. The chart continues and will reflect things through the other side and later we shall look back at today and see these events as a little blip on the chart. It is hard; we stand in the geopolitical and economic cross-hairs. It is unsettling but at some point 'certainty' will trounce 'uncertainty' and this will begin to be reflected in the economics and the values of investments. There are phenomenal opportunities out there.

PRACTICAL THOUGHTS

Just a couple of comments. First, don't keep watching the 'news' – you can't change it and if it is depressing, it won't help your health and capacity of coping. Put investment valuations and reports in a drawer and forget about them for several months. Remember that media sensationalises news to sell stories – media is doing well – with advertising flows to fund them of course. Watching the news is watching the storm. If you see instead how you can plan to come through, it will pass and indeed you will be uplifted by concentrating on constructive and positive things as you cannot change the storm's outcome.

However it appears, it's not all doom and gloom; there are bright spots and especially in simple things. Take small steps with problems you perceive are big. Small steps can lead to big change too (a bit like 'eating elephants'; eat them in small pieces and don't try all in one go!). At some point, reality will return and the markets will regain poise and 'normal' stability. I cannot say when. I can reassure you that income flows into investments are as solid as they have been.

The Association of Investment Companies is reminding us that the last time investment funds' discounts were this big (2008), in the following year the average fund rose by 39% and over the next five years by 119%. Certainly, I cannot guarantee that nor that there will not be further pessimism but the simple mathematical odds of probability are far more favourable to that outcome than further negativity. Sometimes I think we all go out of our ways to simply make this job more complicated than it really is. https://www.theaic.co.uk/aic/news/press-releases/investment-company-discounts-widest-since-2008 And yes, some clients will agree that the times of greatest pessimism are indeed the times to buy sensible-term opportunities and so if funds are sent to us for an ISA, Pension or portfolio, we assure you they will be subscribed very carefully indeed. If something was fair value at £1 and now 75p, you can buy a third more for the amount and receive a third more income into perpetuity. I only use that as an analogy – very few things on the market have fallen like that and a broadly based strategy (as we pursue) will be far more protected than the worst ravages which have impacted some areas and assets on the markets.

I hope that you find my comments helpful. We are here to assist as best as we can. Our Company is strong enough to withstand this latest time through prudence from reserves put aside in previous years. These times are not easy for us either. We have to be realists, not optimists and to guide our clients professionally as we see fit. It's hard on us and our staff but the most we have to gain is to do the very best we can for clients. If that is trying our utmost to encourage them to buy patience and do the sensible thing, then that is what we shall do, whether they have a large or a small pot. Our money is in exactly the same places. We shall not be panicking and neither do we sit still without due cause but at the same time not forgetting we invest clients' real money in real underlying businesses with which you and I trade every day and which pay incomes to us as investors.

And if you do have spare cash funds, think about committing that to some of the cheapest buying opportunities you may see for a very long time.

Till then, the very best wishes from all of the team here.

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